No. 78-687

In the Supreme Court of the United States

OCTOBER TERM, 1978

LOUISIANA LAND AND EXPLORATION COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530

ROBERT R. NORDHAUS
General Counsel

HOWARD E. SHAPIRO
Solicitor

MCNEILL WATKINS, II
Attorney
Federal Energy Regulatory Commission
Washington, D.C. 20426

INDEX

CITATIONS

Cases:

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-687

LOUISIANA LAND AND EXPLORATION COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-9a) is reported at 574 F.2d 204. The opinion denying rehearing (Pet. App. 10a) is reported at 579 F.2d 971. The initial opinion and order (No. 772) of the Federal Power Commission (Pet. App. 13a-27a) and its opinion and order (No. 772-A) denying rehearing (Pet. App. 28a-39a) are not yet reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 11a-12a) was entered on May 30, 1978, and its order denying rehearing (Pet. App. 10a) was entered on September 11, 1978. The petition for a writ of certiorari was filed on October 24, 1978. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether the Federal Power Commission erred in determining that petitioner had made a sale of natural gas in interstate commerce within the jurisdiction of the Commission under Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b).

STATEMENT

In 1955 and 1959, petitioner, the owner of lands in what later became known as the Bastian Bay Field, Louisiana, executed oil and gas leases with a predecessor of Amoco Production Company (collectively referred to as "Amoco"). The leases provided for the payment of royalties to petitioner measured by a percentage (27½% or 30%) of the price at which the lessee sold the gas to third parties. The leases alternatively provided that if the lessee used the gas itself or sold it to an affiliate, the royalties would be the same percentage of the "fair and reasonable value" of the gas (Pet. App. 15a). The leases required petitioner's written consent prior to any assignment, sublease, or other transfer of the leaseholds (Pet. App. 2a, 15a).

Amoco's drilling on its leaseholds confirmed the existence of substantial natural gas reserves (Pet. 4). Instead of selling the gas under a conventional contract, Amoco arranged to assign its leasehold interests to Tennessee Gas Pipeline Company ("Tennessee"), an interstate carrier, at a price equivalent to 21 cents per Mcf of the estimated leasehold reserves (Pet. App. 15a-16a, 18a; see also *Pan American Petroleum Corp.* v. *FPC*, 339 F.2d 694, 695 (10th Cir. 1964), reversed, 381 U.S. 762 (1965)). The Amoco-Tennessee transfer was later found by this Court to have been a "sale" in place of proven natural gas reserves within the meaning of Section 1(b) of the Act and thus subject to the Commission's jurisdiction. *FPC* v. *Pan American Petroleum Corp.*, 381 U.S. 762 (1965). The Court relied on its decision a week earlier in the *Rayne Field* case, *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965). In *Rayne Field*, the Court held that if the economic effect of a transfer is similar to that of a conventional sale, if the subject of the transaction is proven and substantially developed reserves, and if the transfer of the reserves is for the purpose of interstate transmission and resale, the transaction is a "sale" within the meaning of Section 1(b) of the Act. *Id.* at 401.

After Amoco and Tennessee had agreed on the assignment of the leases to Tennessee, Tennessee approached petitioner and offered to purchase petitioner's royalty interest in the leases or, alternatively, to amend the leases to provide that royalty payments be calculated as a percentage of a fixed value for gas

removed from the leaseholds (22.5 cents per Mcf through January 1, 1962, and 25 cents per Mcf thereafter) instead of a percentage of a varying market price (Pet. App. 2a, 33a). Petitioner accepted the offer of fixed-rate royalties, and its acceptance was embodied in a letter contract signed by petitioner, Amoco, and Tennessee. Petitioner thereupon consented to the Amoco-Tennessee assignment (Pet. App. 16a).

The Commission held that petitioner's participation in the lease assignment and renegotiation of royalties constituted the "sale of natural gas in interstate commerce subject to the jurisdiction of the Commission" (Pet. App. 18a). The Commission reasoned that the effect of the transaction was that (*ibid.*):

> Amoco is selling part of the gas to Tennessee for 21 cents per Mcf while [petitioner] is receiving 25 cents for another part of the gas. In our opinion * * * this is a sale and it should be treated as such under the Gas Act.

Accordingly, the Commission determined that petitioner should refund the amount by which its renegotiated royalties exceeded the maximum rates that would have been permissible under a conventional, regulated gas sales contract (Pet. App. 19a-25a).

The court of appeals affirmed (Pet. App. 1a-9a). The court applied this Court's *Rayne Field* test and held (Pet. App. 6a) that petitioner's retained power to withhold consent to the lease transfers,

> coupled as it was with an alteration of the royalty rate, had the effect of altering not only the cost of extracting the gas but also the cost of introducing the gas to commerce. Under these circumstances, we conclude that in economic effect [petitioner] sold gas in interstate commerce subject to FERC jurisdiction.

The court also found the Commission's refund calculation to be supported by substantial evidence (Pet. App. 9a).

In a petition for rehearing, petitioner for the first time argued that if the Commission's refund formula was applied to the production history of the leaseholds and to the royalty payments made in the years since the administrative record was closed, no refunds would now be due. Accordingly, petitioner asked the court for leave to adduce additional evidence before the Commission pursuant to Section 19(b) of the Act, 15 U.S.C. 717r(b) (Pet. App. 45a-46a).

The court denied rehearing, but stated: "[t]he Commission should, however, allow additional hearing on whether refunds should be recalculated * * *" (Pet. App. 10a).[1]

ARGUMENT

The decision below is correct, there is no conflict among the circuits, and the issue presented by the unique facts of this case is not of general or recurring importance.

1. The Commission and the court of appeals correctly applied the principles established in *Rayne Field*, *supra*, in determining that petitioner's trans-

[1] No application for such a hearing has yet been filed with the Commission.

action with Tennessee was in effect a sale of natural gas in interstate commerce and therefore within the Commission's jurisdiction under Section 1(b) of the Natural Gas Act.

Petitioner's claim (Pet. 10-18) that it entered into an ordinary lease and royalty agreement with Tennessee is incorrect. The substance of the various transactions was as follows: Under the original leases, Amoco, as lessee, had a right to produce and sell gas from the leaseholds and was required to pay royalties to petitioner of 27.5% or 30% of Amoco's selling price. Amoco wished to assign all its rights to the gas to Tennessee at a price equivalent to 21 cents per Mcf—an assignment this Court later held to be a jurisdictional sale, *FPC* v. *Pan American Petroleum Corp., supra*. Amoco and Tennessee, however, needed petitioner's consent to the assignment. Petitioner consented to the assignment after renegotiating the royalty provisions to provide petitioner with royalties calculated on the basis of a fixed value for the gas. As the Commission held (Pet. App. 18a), fixing the value of the gas for royalty purposes at 25 cents per Mcf (after January 1, 1962) amounted to a sale of the gas attributable to petitioner's royalty interest—at a price, indeed, higher than the price at which Amoco sold its interest in the gas to Tennessee.[2] In short, the Commission and the court of appeals correctly determined that under this Court's opinion in *Rayne Field*, the economic effect of petitioner's transaction with Tennessee was a jurisdictional sale of gas.[3]

[2] The economic effect of the transactions is the same as if Amoco and petitioner had divided the gas under the leaseholds between them (27.5% and 30% to petitioner and 72.5% and 70% to Amoco), Amoco had sold its portion to Tennessee for 21 cents per Mcf, and petitioner had sold its portion to Tennessee for 25 cents per Mcf.

Indeed, petitioner appears to recognize that the Commission correctly applied *Rayne Field*, since it argues that *Rayne Field* was wrongly decided and that "this Court should consider reshaping its holding * * *" (Pet. 13 & n.18). There is no occasion, however, to reconsider *Rayne Field*, which this Court has cited with approval several times, most recently in *California* v. *Southland Royalty Co.*, 436 U.S. 519, 541 (1978).[4]

[3] Petitioner argues (Pet. 14-18) that the record does not support the Commission's conclusion that petitioner's right to withhold consent to the assignment of the lease to Tennessee was relevant to the terms of the final arrangement between petitioner and Tennessee. The record evidence cited by the Commission belies petitioner's apparent contention that it did not negotiate with Tennessee and did no more than passively consent to Tennessee's proposal (see Pet. App. 31a-34a). But even if there had been no evidence concerning the actual negotiations between petitioner and Tennessee, the Commission would have been justified in concluding that petitioner's right to withhold consent to the assignment was a significant factor leading to the renegotiation of the royalties, and that if the original leases had not given petitioner that right, Tennessee, as assignee, would have been content with the original royalty provisions.

[4] Moreover, the Natural Gas Policy Act of 1978, Pub. L. No. 95-621, enacted November 9, 1978, 92 Stat. 3350, codifies the *Rayne Field* doctrine. That Act defines "sale" to mean "any sale, exchange, or transfer for value" (Section 2(20)), and defines "deliver," with respect to any first sale of natural gas, to include "in the case of the sale of proven reserves in place * * * the transfer of title to such reserves." Section 2(22).

2. Contrary to petitioner's claim (Pet. 9-12), the court of appeals' holding is fully consistent with *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1971), cert. denied, 406 U.S. 976 (1972). In *Mobil*, the court of appeals held that by executing a typical oil and gas lease, a landowner does not make a "sale" of natural gas subject to Commission jurisdiction. As the court stated (463 F.2d at 262; footnote omitted), the lessor of reserves normally has

> no knowledge when the lease is executed of the ultimate destination of any gas that might be discovered, no knowledge whether the gas, if discovered, will be sold either to an interstate pipeline or to any other customer that will move it across state lines. While the lease by the landowner provides for a royalty in the event of the discovery and sale of gas, typically he has no control over any incident of such sale either as to the quantity to be sold, the price to be paid, the identity of the purchaser or whether it shall be sold in interstate or intrastate commerce.

The transaction in this case is not the typical lease transaction described in *Mobil*. Here, proven and substantially developed reserves were the subject of the transfer; the transfer itself was for the purpose of interstate transmission and resale. Petitioner stepped out of the role of the typical royalty owner to affect the incidents of the sale, most particularly the cost of the gas on which the royalty was based. These facts distinguish petitioner from the typical lessor

considered in *Mobil*, as the court of appeals here recognized (Pet. App. 5a-6a).

3. Petitioner also contends (Pet. 18-20) that the court of appeals erred in denying petitioner's motion for leave to adduce additional evidence before the Commission. The proffered evidence relates to gas production and royalty payments in the years since the administrative record was closed; according to petitioner, the new evidence, when the Commission's refund formula is applied to it, would eliminate any refund obligation.

The new evidence proffered does not affect the merits of the Commission's holding, and the proffer implicitly accepts the Commission's methodology for computing refunds. Because the evidence did not controvert the Commission's fundamental conclusions, the court of appeals properly denied the motion. Cf. *FPC* v. *Transcontinental Gas Pipe Line Corp.*, 423 U.S. 326, 331 (1976). In any event, petitioner is now free to present its new evidence to the Commission, by virtue of the court of appeals' direction on petition for rehearing that "[t]he Commission should * * * allow additional hearing on whether refunds should be recalculated * * *" (Pet. App. 10a). Any decision by the Commission on an application to recalculate refunds will be subject to judicial review. Because petitioner has available a complete remedy, there is no reason for further review here.

4. Finally, the events giving rise to this proceeding are unlikely to recur. The lease-sale transaction consummated by Amoco and Tennessee in this case is

similar to other lease-transfer arrangements devised by producers following this Court's decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), in attempting to avoid rate regulation under the Natural Gas Act. Following this Court's holding in *Rayne Field*, the impetus for improvising such transactions evaporated; if the transaction in question "accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States," then that "is the significant and determinative economic fact." 381 U.S. at 401.

Moreover, petitioner's role as a royalty owner in the Amoco-Tennessee transfer appears to be unique. Eight of the nine royalty owners that were parties to the Commission proceeding, for example, did not negotiate separate royalty agreements with Tennessee and were dismissed from the proceeding (Pet. App. 16a, 34a). In no other case subsequent to the decision in *Mobil*, *supra*, has the Commission been presented with facts similar to those presented here. There is, therefore, no reason to believe that the issues raised in this case are of general importance or recurring significance.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

ROBERT R. NORDHAUS
General Counsel

HOWARD E. SHAPIRO
Solicitor

MCNEILL WATKINS, II
Attorney
Federal Energy Regulatory Commission

JANUARY 1979

☆ U. S. GOVERNMENT PRINTING OFFICE: 1978 284165 256